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SUBJECT: RESULTS OF EDRC ANNUAL REVIEW OF JAPAN, JUNE 20

REFS: (A) USOECD 15493

(B) STATE 143376

(C) TOKYO 8140

(D) TOKYO 8145

(E) TOKYO 8033

1. SUMMARY: JAPANESE DELEGATION, LED BY MIYAZAKI OF
ECONOMIC PLANNING AGENCY, RESTATED GOJ COMMITMENT TO
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CAREFULLY-BALANCED POLICY OF STIMULATING ECONOMY JUST

ENOUGH TO ACHIEVE RECOVERY OF DOMESTIC ACTIVITIES BUT NOT SO MUCH AS TO JEOPARDIZE GOJ OBJECTIVE OF SINGLE-DIGIT INFLATION IN JFY 1976. MIYAZAKI ADMITTED THAT RECOVERY HAD BEEN SLOWER THAN ANTICIPATED AND THIS WAS WHY GOJ HAD INTRODUCED THIRD ROUND OF STIMULATORY MEASURES ON JUNE 16. HE DID NOT EXCLUDE POSSIBILITY THAT SUPPLEMENTARY BUDGET MIGHT BE INTRODUCED IN SEPTEMBER TO FURTHER STRENGTHEN DEMAND IF REQUIRED. MIYAZAKI RESTATED JAPANESE TARGETS OF 4 PERCENT REAL GNP RISE IN JFY 1976 AND UNDER 10 PERCENT RISE IN CPI, AND FORECAST CURRENT ACCOUNT DEFICIT OF \$1.7 BILLION. EDRC MEMBERS EXPRESSED SOME DOUBTS ABOUT JAPANESE ABILITY TO ACHIEVE SUSTAINED RECOVERY ON BASIS OF PRESENT POLICY MEASURES, BUT DID NOT PRESS JAPANESE TO TAKE FURTHER ACTION AT THIS TIME. END SUMMARY.

2. GENERAL OUTLOOK: JAPANESE SEE SIGNS OF RECOVERY ALREADY UNDERWAY IN SECOND QUARTER, WITH INDEX OF INDUSTRIAL PRODUCTION RISING FOR MOST RECENT TWO MONTHS FOR WHICH DATA AVAILABLE. THEY NOW EXPECT REAL GNP TO DECLINE ONLY 1 PERCENT IN FIRST HALF OF 1975, FOLLOWED BY 6-7 PERCENT INCREASE IN SECOND HALF AND 7 PERCENT INCREASE IN 1976-I. THEY PROJECT FULL-YEAR INCREASE OF 2 PERCENT IN 1975, WITH ERROR BAND VARYING FROM PLUS 1 TO PLUS 4. LEADING SECTORS IN RECOVERY ARE EXPECTED TO BE PERSONAL CONSUMPTION (PLUS 5 PERCENT) AND GOVERNMENT SPENDING (PLUS 4 PERCENT). JAPANESE DO NOT EXPECT ANY STIMULUS TO DOMESTIC ACTIVITY FROM EXPORTS DURING 1975, AND BELIEVE PRIVATE INVESTMENT WILL BE VERY WEAK (-6 TO -8 PERCENT) AS RESULT OF PRESENT LOW LEVELS OF CAPACITY UTILIZATION.

3. SECRETARIAT AND COMMITTEE EXPRESSED SOME DOUBTS REGARDING TIME PATH OF RECOVERY, ALTHOUGH SECRETARIAT RECOGNIZED THAT TURNAROUND APPEARED TO HAVE OCCURRED ONE QUARTER EARLIER THAN PREVIOUSLY EXPECTED. SECRETARIAT HAS CONSEQUENTLY REVISED UPWARDS ITS GNP FIGURES FOR CY 1975 FROM -0.5 PERCENT TO PLUS 1.1 PERCENT. THIS REVISION WAS MADE PARTLY IN EXPECTATION OF FURTHER MILD STIMULUS ANNOUNCED BY GOJ ON JUNE 16, AND SECRETARIAT LIMITED OFFICIAL USE

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DOES NOT INTEND TO MAKE FURTHER UPWARD REVISIONS AT PRESENT. EXAMINING COUNTRIES (FRANCE AND U.K.) BOTH EXPRESSED DOUBTS ABOUT STRENGTH OF UPTURN IN VIEW OF LARGE DEGREE OF SLACK, WEAKNESS OF PRIVATE INVESTMENT AND HOUSE BUILDING, AND LIKELIHOOD THAT SAVINGS RATIO WOULD NOT BEGIN TO FALL UNTIL EMPLOYMENT UNCERTAINTIES ARE RESOLVED, WHICH COULD MEAN THAT PERSONAL CONSUMPTION WOULD BE SOMEWHAT WEAKER AUTONOMOUS FACTOR IN EXPANSION.

4. OUTLOOK FOR PRICES AND WAGES: JAPANESE WERE CLEARLY PLEASED WITH THEIR ABILITY TO REDUCE RATE OF GROWTH OF WAGES FROM OVER 30 PERCENT LAST YEAR TO EXPECTED 15 PERCENT THIS YEAR (13 PERCENT WAGE ROUND PLUS 2 PERCENT FOR OVERTIME AND OTHER ADJUSTMENTS), AND ATTRIBUTED THIS TO REDUCTION IN INFLATION RATE AND TO SLACKNESS IN LABOR MARKET. LOWER WAGE INCREASES WOULD CONTRIBUTE TO ACHIEVEMENT OF JAPANESE GOAL OF SINGLE-DIGIT INFLATION RATE BY END OF JFY 1976. OTHER FACTORS HOLDING DOWN RATE OF INCREASE IN PRICES HAVE BEEN WEAKNESS OF RAW

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MATERIALS PRICES ON INTERNATIONAL COMMODITY MARKETS AND DEGREE OF SLACK IN DOMESTIC ECONOMY. MAIN DANGER OF RESURGENCE OF PRICES LIES IN POSSIBILITY THAT ECONOMY WILL RECOVER TOO QUICKLY AND LEAD TO EFFORTS BY PRIVATE BUSINESS TO RECONSTITUTE SQUEEZED PROFIT MARGINS. JAPANESE ARE ALSO CONCERNED ABOUT POSSIBLE OIL PRICE RISE IN FALL.

5. SECRETARIAT ANNOUNCED THAT ITS FORECASTS FOR YEAR-ON-YEAR CPI RISE IN 1975 HAD BEEN INCREASED FROM 9.75 PERCENT TO 12.5 PERCENT ON BASIS OF MORE RAPID RATE OF INFLATION IN MOST RECENT TWO MONTHS. U.S. DEL ASKED IF LIMITED OFFICIAL USE

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THESE RESULTS WOULD JEOPARDIZE JAPANESE TARGET OF SINGLE-DIGIT INFLATION, AND WAS TOLD THAT PERHAPS TARGET WOULD NOT BE ACHIEVED, BUT POLICIES WOULD HAVE TO REMAIN CAUTIOUS IN ORDER TO GIVE EVERY CHANCE OF DOING SO.

6. POLICY STANCE: MIYAZAKI MADE VERY CLEAR THAT CONTROL OF INFLATION REMAINS NUMBER ONE PRIORITY OF GOJ AND THAT MEASURES TO STIMULATE RECOVERY OF ECONOMY WOULD HAVE TO REMAIN CAUTIOUS TO AVOID RESURGENCE OF INFLATION DURING COMING UPTURN. IN PARTICULAR, JAPANESE POLICY-MAKERS ARE WORRIED BY SURVEY REPORTS THAT 70 PERCENT OF BUSINESSES WANT TO RAISE PRICES TO IMPROVE PROFIT MARGINS AS SOON AS THERE IS RECOVERY OF DOMESTIC DEMAND. ANOTHER REASON FOR CAUTION IS THAT JAPAN SEES DRAMATIC REDUCTION IN GROWTH POTENTIAL FROM ALMOST 10 PERCENT ANNUAL RATE OF 1960'S (SEE PARA 11 BELOW), AND DOES NOT WANT TO RISK CREATION OF BOTTLENECKS BY GIVING EXCESSIVE STIMULUS TO ECONOMY. IN PARTICULAR, THIS MEANS THAT GOJ WILL ONLY TRY TO INCREASE LEVEL OF CAPACITY UTILIZATION TO ABOUT 90-PERCENT LEVEL IN ORDER TO AVOID RECURRENCE OF INVESTMENT BOOM WHICH CHARACTERIZED 1972-73 RECOVERY. JAPANESE DEL EXPRESSED CONFIDENCE THAT THIRD-ROUND MEASURES OF JUNE 16 WOULD BE SUFFICIENT TO ASSURE SUSTAINABLE RECOVERY WITHOUT BEING SO STRONG AS TO REFUEL INFLATION. HE WAS UNABLE TO SPECIFY EXTENT OF STIMULATIVE IMPACT ON INDIVIDUAL SECTORS OF ECONOMY, BUT STATED THAT TOTAL STIMULUS WOULD AMOUNT TO ABOUT 1.8 BILLION YEN OR 1 PERCENT OF GNP.

7. U.S. DEL IN PRE-MEETING DISCUSSION WITH JAPANESE WAS TOLD THAT THEY SEE THIRD-ROUND MEASURES AS ANSWER TO SECRETARIAT RECOMMENDATIONS FOR FURTHER STIMULUS TO ECONOMY. THEY DO NOT EXCLUDE POSSIBILITY THAT FURTHER MEASURES MIGHT HAVE TO BE TAKEN IN SEPTEMBER, BUT FOR TIME BEING THEY ARE

CONTENT TO FOLLOW INCREMENTALIST APPROACH. LATER, IN PLENARY SESSION, U.K. DEL ASKED IF BRINGING FORWARD 70 PERCENT OF PUBLIC EXPENDITURES INTO FIRST HALF OF JFY MIGHT LEAD TO LOWER EXPENDITURES LATER IN YEAR, TO WHICH MIYAZAKI REPLIED THAT THERE WERE NO PRESENT PLANS FOR SUPPLEMENTARY EXPENDITURES IN VIEW OF TWO-QUARTER LIMITED OFFICIAL USE

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TIME-LAG BEFORE RESULTS OF THIRD ROUND WOULD BE KNOWN. BUT IF FURTHER MEASURES WERE REQUIRED, THEY COULD BE TAKEN IN SEPTEMBER, WHICH USUALLY IS OCCASION FOR SUPPLEMENTARY BUDGET. BANK OF JAPAN REP SAID THAT MONETARY POLICY WOULD REMAIN CONSISTENT WITH OVERALL POLICY STANCE, BUT RESTORATION OF PRICE STABILITY WOULD HAVE HIGHEST PRIORITY.

8. U.K. REP EXPRESSED STRONG DOUBTS THAT JAPAN COULD ACHIEVE 4 PERCENT GROWTH TARGET IN JFY 1976 WITH PRESENT LEVEL OF DOMESTIC DEMAND STIMULUS, AND ASKED IF JAPANESE WERE LOOKING TO EXTERNAL SECTOR FOR NECESSARY BOOST. MIYAZAKI DENIED THAT JAPAN WAS EXPECTING EXPORT BOOST TO ECONOMY, AND SAID THAT EVEN IF THIRD-ROUND MEASURES WERE "TOO LITTLE TOO LATE," THEY WERE BETTER THAN "TOO MUCH TOO SOON" IN VIEW OF INFLATION RISK AND MEDIUM-TERM GROWTH OBJECTIVES.

9. U.S. DEL SUGGESTED THAT FINAL PARAGRAPHS OF SURVEY MIGHT REFLECT EDRC JUDGMENTS SLIGHTLY MORE ACCURATELY IF MOST IMMEDIATE PROBLEM OF ASSURING SUSTAINABLE RECOVERY OF ECONOMIC ACTIVITY WAS TO BE DISCUSSED FIRST IN CONCLUSIONS (PARA 70 REFDOD) BEFORE DISCUSSION OF DANGER OF RESURGENCE OF INFLATION WHICH MIGHT RESULT IN 12 TO 18 MONTHS' TIME (PARA 69). IN SHORT, RECESSION IS HERE AND NOW, BUT INFLATION RISK WILL COME ONLY IF THERE IS TOO STRONG RECOVERY NEXT YEAR. U.S. DEL ALSO SUGGESTED THAT IN VIEW OF DEPRESSED OUTLOOK FOR INVESTMENT IN PARA 65, IT MIGHT BE DESIRABLE TO MAKE CLEAR IN PARA 72(I) THAT SECRETARIAT RECOMMENDATION OF "A RELATIVELY RESTRICTIVE STANCE OF MONETARY POLICY TO PREVENT

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A TOO STRONG EXPANSION OF BUSINESS FIXED INVESTMENT"
WAS MEANT TO APPLY TO FUTURE PERIOD WHEN UPTURN MATURES.
MIYAZAKI RESPONDED BY EXPRESSING PREFERENCE FOR CURRENT
DRAFT'S SEQUENTIAL EMPHASIS ON INFLATION AS FIRST DANGER
FOR JAPANESE ECONOMY, BUT DID NOT OBJECT TO SOME ADJUST-
MENT IN PARA (72(I)). HE ALSO DID NOT OBJECT TO SECRE-
TARIAT REFERENCES IN PARA 71 TO DESIRABILITY OF SOMEWHAT
STRONGER RECOVERY FROM INTERNATIONAL POINT OF VIEW.

10. BALANCE OF PAYMENTS: GOJ FORECASTS JFY 1976 SUR-
PLUS ON TRADE ACCOUNT OF \$5.2 BILLION AND DEFICIT OF
\$1.7 BILLION ON CURRENT ACCOUNT. EXPORT VOLUME EXPECTED
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TO BE BETWEEN MINUS 2 AND PLUS 2 PERCENT AND IMPORT
VOLUME TO DECLINE BETWEEN 4 AND 6 PERCENT. ON CAPITAL
ACCOUNT, JAPANESE DEL FORECAST \$2.2 BILLION DEFICIT IN

JFY 1976. OFFICIAL POLICY ON CAPITAL FLOWS IS TO ENCOURAGE OUTFLOWS IF INFLOWS OF FOREIGN CAPITAL CONTINUE TO INCREASE. JAPAN WOULD LIKE TO BECOME NET EXPORTER OF LONG-TERM CAPITAL, AND IT DOES NOT INTEND AS MATTER OF POLICY TO RELY ON SHORT-TERM CAPITAL INFLOWS FOR CURRENT ACCOUNT FINANCING. ON EXCHANGE RATE, BASIC POLICY IS TO MAINTAIN CLEAN FLOAT UNLESS IT IS NECESSARY TO OFFSET ABRUPT SPECULATIVE MOVEMENTS. FRENCH EXAMINER SUGGESTED THAT EXPORT PROSPECTS MIGHT BE ADVERSELY Affected BY GROWING SIZE OF LDC DEBT BURDENS, AND THIS MIGHT HAVE FURTHER NEGATIVE EFFECT ON DOMESTIC RECOVERY.

11. MEDIUM-TERM DEVELOPMENTS: JAPANESE DEL SAID THAT GOJ IS EXPECTING DRAMATIC CHANGE IN POTENTIAL RATE OF GROWTH, WITH ECONOMY GROWING AT 5-7 PERCENT RATE IN FUTURE INSTEAD OF 10 PERCENT EXPERIENCED IN 1960'S. REASONS FOR THIS WERE (1) SUPPLY CONSTRAINTS ON ENERGY, RAW MATERIALS AND LAND, (2) GREATER INVESTMENT IN SOCIAL PROGRAMS, (3) REDUCTION OF WORKING HOURS, (4) REDUCTION IN POPULATION GROWTH RATE, AND (5) GREATER CONCERN FOR QUALITY OF GROWTH. U.K. DEL ASKED WHAT WOULD HAPPEN TO JAPANESE MERCHANDISE TRADE IF THEIR GROWTH RATE SLOWED DOWN AND REST OF WORLD'S DID NOT. MIYAZAKI AGREED THAT EXPORTS LIKELY TO RISE AND IMPORTS TO FALL UNLESS OTHER COUNTRIES ALSO GROW AT SLOWER PACE. HE FELT THIS PROBLEM DESERVED FURTHER STUDY AND COORDINATION WITHIN OECD.

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